RECENT DEVELOPMENTS

INSURANCE COMPANY'S ARBITRARY BEHAVIOR IS NOT BAD FAITH

Slater v. Motorists Mutual Insurance Co.
174 Ohio St. 148, 187 N.E.2d 45 (1962)

An insured automobile driver struck a pedestrian at an intersection in Zanesville, Ohio. After pleading guilty to the charge of failure to yield the right of way, he was sued by the pedestrian for $69,681.52. The insured notified his insurance company and the company assumed the defense, advising him of his right to employ independent counsel—a right which apparently was never exercised. Counsel for the pedestrian wrote the insurer that, as a result of conversations with two of the insurer's agents, he inferred that maximum coverage under the insurance policy was $5000 but that neither agent had been definite on the subject. The purpose of the letter was to inform the insurer that the injured party would settle the claim for the policy limit. The offer was to remain open until the final jury verdict was returned.

Immediately preceding the trial, counsel for the insurer offered to settle the case for $5000 and pay the costs. However, the insurance company would not officially disclose the policy limits, thus precluding settlement. A verdict in favor of the injured pedestrian was returned for $20,000. The maximum liability of the insurance company *was* $5000, leaving the insured with a personal liability of $15,000.

The insured thereupon sued the insurance company for $15,000 asserting that its obstinancy in refusing to reveal officially the policy limit and thus settle the suit for $5000 constituted a lack of good faith. The common pleas court found for the insured and the court of appeals affirmed without written opinion. The supreme court, by a narrow 4-to-3 margin, reversed the lower courts and held that "although . . . [the insurance company's behavior] may have been arbitrary and a display of poor judgment . . . , [its conduct] . . . falls short of bad faith as a matter of law."[1]

The one Ohio authority cited by the court was *Hart v. Republic Mutual Insurance Co.*,[2] the only case involving an insurer's responsibility to settle within policy limits which has heretofore reached the supreme bench in Ohio. In *Hart* the court adopted the lack of good faith test as opposed to the negligence test which a minority of jurisdictions has adopted.[3] In the personal injury suit, claimant sued for $31,000 and before trial the insurer refused three separate offers to settle, at $1113, $4500, and $4000. Policy limits were $6000/12,000. A verdict of $19,400 was returned and levy was had upon the insured trucker's two trucks which were his only means of livelihood. Even

[1] Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 152, 187 N.E.2d 45, 48 (1962).

[2] 152 Ohio St. 185, 87 N.E.2d 347 (1949).

[3] See Annot., 71 A.L.R. 1485 (1931), 131 A.L.R. 1500 (1941), 40 A.L.R.2d 178 (1955).

after judgment, the insured induced the claimant to settle for $6000, but again the insurer refused. Hart recovered a verdict from the insurance company, but the trial court charge erroneously allowed the jury to find on either negligence or bad faith. The supreme court reversed but remanded, holding that the jury might have found against the insurer if charged upon "bad faith" alone.

The court rejected the negligence test and looked to the insurer's behavior as measured against the bad faith test. A bona fide belief in the lack of liability might justify a refusal to settle, but "such a belief may not be an arbitrary or capricious one."[4] The judges concluded that the injuries involved were serious and permanent, that the company had no eyewitnesses in its behalf, and that the first offer of settlement had been small. Even later offers were but a fraction of the verdict. In addition, both the insured and insurer's local agent had pleaded with the home office to settle. From this record the court determined that a jury might have found bad faith.

Two earlier Ohio courts of appeals have wrestled with the settlement question.[5] Neither of these cases was mentioned in *Slater* although both purport in their syllabi to adopt the "lack of good faith" rule applied in *Slater*.

Cleveland Wire held that the insurer was not required to settle by "good faith" and that he had the right to estimate and value the probability of the claimant's recovering a large verdict. Here the policy limit was $5000. The insured prompted a settlement offer from the claimant for $7500 and offered to pay $2500 of his own if the insurer would put up $5000. The insurer offered only $3500. No settlement was reached, and a $20,000 verdict was returned. Apparently the insurer had warned the insured that the verdict would probably be in excess of $10,000. By its offer of settlement, however, it admitted its liability only to the extent of 70% of the coverage. Here the court protected the insurer's right to "gamble" on the probability of a large verdict—a right, according to the court, which insured valued at $1500. It might be surmised that this case formulates a mathematical test for good faith based upon how highly the insurer values his right to gamble on the verdict.

Although *Spang* adheres to the bad faith test in the syllabus, one wonders after reading the opinion if the actual test applied was not in fact one of negligence or due care. The court reversed and remanded a lower court's directed verdict for the defendant-insurer, holding that on the facts a jury might have found for the insured. The policy limits were $10,000/20,000. Suits totalling $55,000 were brought by the injured claimant. An offer of settlement was made by claimant for $5500 but the insurer refused, asserting as a reason the fact that it had reinsured $5000 of its liability. The insurer offered $4250 and no more, asking the insured to put up $1250. Since the insurance company feared that the verdict would go over the policy limits, it urged the insured to settle.

Much of the language in the opinion, taken from supporting cases, was

[4] Hart v. Republic Mut. Ins. Co., *supra* note 2, at 188, 87 N.E.2d at 349.

[5] Cleveland Wire Spring Co. v. General Acc., Fire & Life Assur. Corp., 6 Ohio App. 344 (1917), *motion to certify overruled,* 62 Ohio L.B. 315 (1917); Spang Baking Co. v. Trinity Universal Ins. Co., 45 Ohio L. Abs. 577, 68 N.E.2d 122 (Ct. App. 1946).

directed toward negligence and the reasonable course under the circumstances. The court concluded its opinion:

> The foregoing cases represent the almost unanimous holding of the courts of last resort on the duty of an insurer to act *fairly* and *exercise reasonable care* to protect the interests of its assured in any *reasonable* offer of settlement made within the coverage of the policy upon a claim against the assured. (Emphasis added.)[6]

This opinion seems essentially to merge the bad faith test with the negligence test—a result which one eminent authority feels is certainly not aberrational.[7] Unfortunately the *Hart* and *Slater* decisions seem to rebuke the explanation of the bad faith rule as articulated in *Spang* and appear to be thwarting the modern trend toward encouraging settlement by insurers at a reasonable offer within the policy limits.

The result reached by the supreme court in *Slater* is not only shocking to an ordinary sense of right and justice, but it is very questionable when viewed in the light of what little Ohio authority exists. Here the insurance company offered to settle for $5000, the maximum amount for which it could be liable under the policy limits. It knew that all it need do to settle was inform opposing counsel officially of the policy limits. Yet it refused to do so. The court calls this behavior good faith. In fact Judge Zimmerman, writing for the majority, shifts the onus of blame, suggesting that the claimant's behavior was unreasonable: "By the information coming to him from two sources, counsel for [claimant] could not reasonably have doubted that the maximum limit of liability under the policy was $5000."[8]

Did not counsel for the injured pedestrian have a right to condition his settlement upon official disclosure? Was he required by the rule of reason to settle his claim without knowing to his satisfaction what the actual coverage was? His claim was certainly a good one, or so the insurer thought, as indicated by its offer to settle for an amount equal to its maximum liability. What conceivable good faith reason could the insurance company have had for refusing to make the requested official revelation when it was ostensibly willing to pay out all that it could possibly be held liable for under the contract? This refusal is clearly obtuseness of the rankest variety. The court itself calls it "arbitrary and a display of poor judgment."[9] Yet this, says the Ohio court, is "good faith," for to say otherwise is to reach "an unfair and wrong result."[10]

The one Ohio case cited by Judge Zimmerman certainly does not dictate this result. There the court, announcing the "bad faith" test while holding

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[6] *Id.* at 586, 68 N.E.2d at 127.

[7] Keeton, "Liability Insurance and Responsibility for Settlement," 67 Harv. L. Rev. 1136, 1141 (1954): "With the skillful advocacy for the insured . . . the 'bad faith rule' in operation is close to the practical equivalent of the 'negligence rule' even if the standards themselves are sharply distinguished."

[8] Slater v. Motorists Mut. Ins. Co., *supra* note 1, at 152, 187 N.E.2d at 48.

[9] *Ibid.*

[10] *Ibid.*

against the insurer and remanding for further jury determination, suggested that a test for bad faith was whether the insurer had a bona fide belief in lack of liability on its part, *i.e.*, "reasonable justification."[11] The court said that the insurer's behavior must not be "arbitrary."[12] In *Slater* the court says the insured acted in an arbitrary manner but that is not bad faith.

Although the other two Ohio cases discussed above were not cited in *Slater*, they certainly are relevant to the question of what the bad faith test is in Ohio. Even though *Cleveland Wire* went against the insured, it suggested that the insurer's activity was justified because is had a right to gamble on the probability of the claimant's recovering less than the policy limits. By offering to settle for $3500 under a potential liability of $5000, the insurer valued his right at $1500. How highly does the insurance company in *Slater* value its right when it offers to settle for $5000 under a potential liability of $5000? This offer of settlement is tantamount to an admission on the part of the company that it is liable to the full amount of the policy. In *Cleveland Wire* the court emphasized the fact that the insurance company had in no way admitted liability to the full extent of coverage.[13]

Spang, although articulating a bad faith rule in the syllabus, applied the equivalent of a negligence test. Under that application, Motorists Mutual in *Slater* can hardly be said to have acted "fairly" and "with reasonable care to protect the interests of its assured in any reasonable offer of settlement made within [policy limits]. . . ."[14]

Thus it appears that this most recent application of the "bad faith" rule comports neither with fairness nor judicial precedents in Ohio. It forebodes a protectionist policy for the insurance companies. It is true, as Judge Taft said in his dissent in *Hart*, that if the insured wants more insurance, he can buy it.[15] But should Mr. Slater be required to buy more insurance to cover a claim which his insurance company can settle within the $5000 policy?

It is suggested that the extent to which the insurance company reasonably recognizes that there is a very strong case against its insured should weigh heavily in a court's mind when it applies the bad faith test to a refusal to settle within policy limits. An offer to settle for $5000 against a potential liability of $5000 indicates convincingly that Motorists Mutual thought very little of its chances in the courtroom. With this as background, an arbitrary refusal to disclose officially the limits of the policy is "bad faith" by any reasonable test—the equivalent of an arbitrary and capricious refusal to settle.

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[11] Hart v. Republic Mut. Ins. Co., *supra* note 2, at 188, 87 N.E.2d at 349.

[12] *Ibid.*

[13] Cleveland Wire Spring Co. v. General Acc., Fire & Life Assur. Corp., *supra* note 4, at 353.

[14] Spang Baking Co. v. Trinity Universal Ins. Co., *supra* note 6, at 586, 68 N.E.2d at 127.

[15] Hart v. Republic Mut. Ins. Co., *supra* note 2, at 190, 87 N.E.2d at 350.